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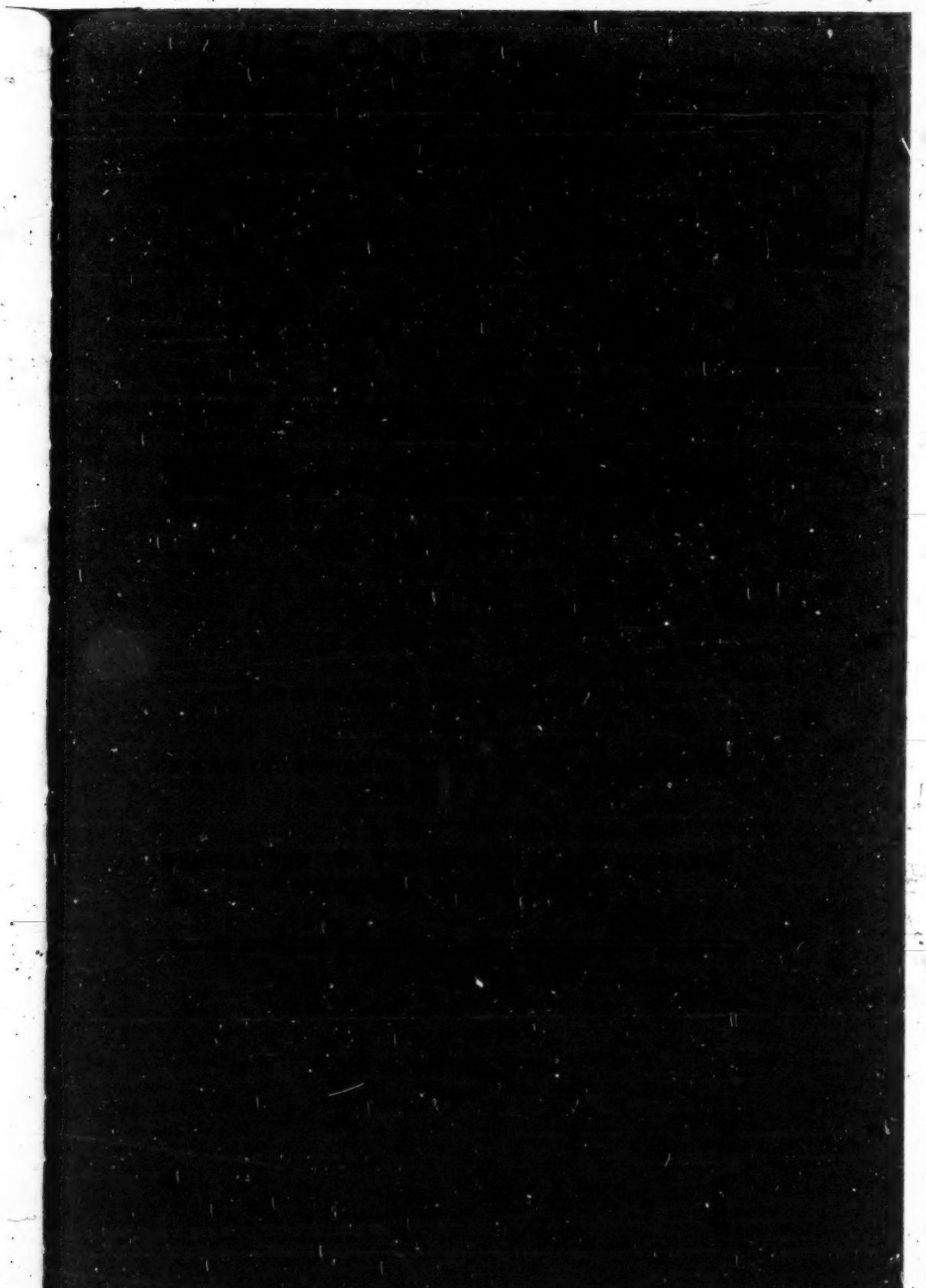

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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 78

A. C. FROST & COMPANY, PETITIONER

v.

COEUR D'ALENE MINES CORPORATION

ON WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF IDAHO

MEMORANDUM FOR THE SECURITIES AND EXCHANGE COMMISSION, AMICUS CURIAE

OPINIONS BELOW

The findings of fact, conclusions of law and judgment of the District Court of Kootenai County, Idaho (R. 205–219), are not reported. The opinion of the Supreme Court of Idaho (R. 226–235), as modified by the order denying a rehearing (R. 235), is unofficially reported at 98 P. (2d) 965.

JURISDICTION

The judgment of the Supreme Court of Idaho was entered on December 15, 1939 (R. 226–227,

234–235). Its order amending its opinion and denying petition for rehearing was entered on February 15, 1940 (R. 235). The petition for certiorari was filed on May 15, 1940, and granted on October 14, 1940. The jurisdiction of this Court rests upon Section 237 (b) of the Judicial Code, as amended by the Act of February 13, 1925.

The judgment of the Supreme Court of Idaho (R. 226–227, 234–235) affirmed a judgment for the defendant upon the first cause of action and reversed a judgment for plaintiff upon the second cause of action, with directions to enter judgment for defendant on the second cause of action. The Supreme Court rested its decision upon the determination that "the dealings between Frost & Company and Coeur d'Alene Mines Corporation were in contravention" of Section 77e of the Securities Act of 1933 and that the "option agreement is void because prohibited by law" (R. 228–229, 231–232). Compare *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209, 213–214; *Danciger* v. *Cooley*, 248 U. S. 319, 322, 328.

STATUTE INVOLVED

The statute involved is the Securities Act of 1933 (48 Stat. 74, 15 U. S. C., Sec. 77 *et seq.*). The pertinent provisions are set forth, *infra*, in Appendix A.

QUESTIONS PRESENTED

1. Whether, under the circumstances, the sales of treasury stock, pursuant to agreement between

the parties, were by Section 4 (1) exempted from the provisions of Section 5 (a) of the Securities Act of 1933.

2. If not, whether the underwriter who participated with the issuer in making such sales in violation of Section 5 (a) can recover from the issuer (a) damages for the issuer's refusal to deliver all the stock covered by the underwriting agreement, or (b) underwriting profits resulting from sales of the delivered stock.

STATEMENT

The relevant findings of the trial court (R. 205–217) may be summarized as follows:

Petitioner, through its agent, one Boland, entered into a contract dated September 10, 1934 (herein referred to as the option agreement), with respondent whereby respondent agreed to give Boland the "sole and exclusive right and option to purchase the whole or any part" of 1,300,000 shares of treasury stock at the price of ten cents per share, payable in specified installments (R. 209–211). The option agreement, by instrument dated September 10, was assigned by Boland to petitioner, who was thereafter dealt with by respondent as the party to the agreement (R. 211). On April 26, 1935, the agreement was modified to reduce and alter the payments which petitioner was required to make (R. 211–212).

On May 15, 1935, the option agreement was again modified so as to authorize respondent to

sell the shares of stock crediting petitioner with the proceeds over and above ten cents per share (R. 212–213).

Petitioner, in accordance with the option agreement, received 165,000 shares of stock for which it paid $16,500 (R. 213). In addition, petitioner caused to be paid to respondent the option price of ten cents per share for 279,850 shares sold to parties other than petitioner (R. 214). As a result of these latter sales, respondent owed petitioner $16,306, plus interest—a total of $19,132.38 (R. 216–217). During June 1935 respondent refused to deliver to petitioner any more stock, of which at least 805,150 shares were then unsold, on the ground that the stock had not been registered with the Securities and Exchange Commission (R. 215).

The shares of stock covered by the option agreement were never registered for sale under the Securities Act of 1933, or its amendatory acts (R. 215). It appears to be conceded that the stock covered by the option agreement was sold by the use of the mails and means or instruments of transportation and communication in interstate commerce (R. 229).

The trial court held that the option agreement was entered into in violation of the Securities Act of 1933, and its amendatory acts, and was not enforceable as to its unexecuted parts (R. 218). It then gave judgment for respondent on the first

cause of action, for damages for refusal to deliver the stock under the option agreement, and for petitioner on the second cause of action, for the excess above ten cents received on the sales to others (R. 218).

On appeal, the Supreme Court of Idaho affirmed the judgment for respondent on the first cause of action and reversed the judgment for petitioner on the second cause of action, with directions to enter judgment for respondent on the second cause of action (R. 226–227, 234–235).

INTEREST OF THE SECURITIES AND EXCHANGE COMMISSION

The Commission is not a party to this case. The Supreme Court of Idaho, however, rested its decision upon an interpretation of certain provisions of the Securities Act of 1933, as amended, the administration of which Congress has conferred upon the Commission. This brief is filed in order to inform the Court as to the views of the Commission on the questions presented insofar as the Securities Act of 1933 may be thought to have a bearing on their determination.

ARGUMENT

A. THE SALES OF THE TREASURY STOCK COVERED BY THE OPTION AGREEMENT WERE NOT, BY SECTION 4 (1) OF THE ACT, EXCEPTED FROM SECTION 5 (A)

The sales of the treasury stock covered by the option agreement concededly violated Section 5 (a)

of the Act unless the original sale to petitioner was covered by the specific exception for "transactions by an issuer not involving a public offering" conferred by Section 4 (1) (see R. 229; Pet. Br. 24–28; Rspt. Br. 7–14). The scope of the exemption given by Section 4 (1) thus becomes a pivotal issue in this case. Its determination, of course, turns not upon the law of Idaho but upon the intention reasonably to be ascribed to Congress. See *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209, 213–214; *Danciger* v. *Cooley*, 248 U. S. 319, 322, 328.

The critical words assume their proper content when viewed in their setting in the regulatory scheme. *United States* v. *American Trucking Ass'ns*, 310 U. S. 435, 541–544; *United States* v. *Dickerson*, 310 U. S. 554, 561–562. The basic policy of the Act, in brief, is to protect the investing public by insisting that "every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information, and that no essentially important element attending the issue shall be concealed from the buying public." Message of the President to the Congress, March 29, 1933, H. Rep. No. 85, 73d Cong., 1st Sess. p. 1. See also Sen. Rep. No. 47, 73d Cong., 1st Sess. The statutory scheme to accomplish these ends contemplates that a "registration statement" describing the securities and the issuing corporation shall be filed with the Commission and that a "prospectus" summarizing the information contained in

the registration statement shall be furnished to the purchaser in connection with all offers or sales of securities made through the mails or any instrumentality of interstate commerce. Section 5 (a), accordingly, declares generally that it shall be unlawful for any person to sell, offer to buy, or to transport for the purpose of sale or delivery after sale a security by the use of the mails or any instrumentality of interstate commerce, unless a registration statement is in effect as to the security. And Section 5 (b) forbids the transportation for the purpose of sale or delivery after sale of registered securities by the use of such means, unless a copy of the prospectus is given to the purchaser. Sections 11 and 12 create certain civil liabilities and, by implication, permit the purchaser to affirm the sale. Section 24 provides criminal penalties for any person who wilfully violates any provision of the Act. Section 16 states that the "rights and remedies provided by this Title shall be in addition to any and all other rights and remedies that may exist at law or in equity."

The exemption[1] from this scheme of "transactions by an issuer not involving a public offering" was intended to meet a narrow group of cases. Thus the Commerce Committee, in reporting the bill to the House, stated with reference to Section 4 (1): "Again, it exempts transactions by an is-

[1] There are no exemptions or exceptions from Section 17, prohibiting frauds.

suer unless made by or through an underwriter[2] *so as to permit an issuer to make a specific or an isolated sale of its securities* to a particular person, but insisting that if a sale of the issuer's securities should be made generally to the public that that transaction shall come within the purview of the Act." [Italics supplied.] H. Rep. No. 85, 73d Cong., 1st Sess., pp. 15–16.

The Commission, pursuant to its duty to administer the regulatory scheme, has issued two releases setting forth the opinion of its General Counsel as to the proper construction of the exemption in question here. S. E. C. Release Nos. 285 (Jan. 24, 1935) and 603 (Dec. 16, 1935), *infra*, Appendix B. Release No. 285 (Jan. 24, 1935) points out that "all surrounding circumstances are of moment" and that, among other factors, "it would appear to be proper to consider not merely the specific transaction or transactions between the issuer and the initial purchasers, but also the extent to which a later public offering of all or

[2] Section 4 (1) of the original Act exempted: "Transactions by an issuer not with or through an underwriter and not involving any public offering." 48 Stat. 77. It was amended, by the Securities and Exchange Act of 1934, so as to strike out the words "not with or through an underwriter." 48 Stat. 906. The amendment was explained in the Conference Report (H. Rep. No. 1838, 73d Cong., 2d Sess., p. 41): "The Commission has recognized by its interpretations that a public offering is necessary for distribution. Therefore there can be no underwriter within the meaning of the act in the absence of a public offer and the phrase eliminated in the second clause is really superfluous."

part of the securities sold by the issuer is likely." Its supplementary release, No. 603 (Dec. 16, 1935), in answer to an inquiry as to whether a dealer might resell to the public without registration securities initially purchased in connection with a "private offering," states that "the answer to your question depends upon whether the initial purchaser acquired the securities with a view to distribution * * * if his acquisition was with such intent, he would be an underwriter, so that in general sales by dealers of securities bought from him would not be exempt from registration. * * * the intent of the initial purchaser at the time of acquisition is a question of fact * * *." This administrative construction, we submit, is in complete accord with the intent of Congress and should receive approval at the hands of this Court.[3]

Petitioner, while admitting that the issue is "largely a question of fact" (Br. 25), contends

[3] See *Securities and Exchange Commission* v. *Associated Gas & Electric Co.*, 99 F. (2d) 795, 798 (C. C. A. 2d): "Moreover, we are dealing with a new act the administration of which is the peculiar function of the Securities and Exchange Commission. One of the principal reasons for the creation of such a bureau is to secure the benefit of special knowledge acquired through continuous experience in a difficult and complicated field. Its interpretation of the act should control unless plainly erroneous. In no other way can the objects of the act be attained without constant and disconcerting friction." See also *United States* v. *American Trucking Associations*, 310 U. S. 534; *Norwegian Nitrogen Products Co.* v. *United States*, 288 U. S. 294.

that the option agreement did not involve an offer to the public, but merely "an offer to sell all the stock of the corporation remaining in its treasury to but one person, petitioner" (Br. 24). It therefore claims that the subsequent sales to the public were exempt from the registration requirements of the Act (Br. 24–28).

The securities Act of 1933, as indicated above, provides in Section 5 (a) for a general prohibition against sales in interstate commerce without registration. Section 4 (1) excepts certain transactions including, among others, transactions by an issuer not involving any public offering, i. e., purchases not with a view to distribution. S. E. C. Release Nos. 285 and 286, *infra*, Appendix B. If in fact petitioner had purchased the treasury stock for purposes of investment, without any view to a public offering, and had later changed its mind and made a public offering, doubtless, both the sale to it and its subsequent resales to the public would have been exempt from the registration requirements of the Act. But petitioner, claiming the benefit of this exception, must prove its existence.[4]

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[4] Rule 152, *infra*, Appendix C, relied upon by petitioner (Br. 26), has no bearing on this case. The Commission, in promulgating the rule, stated: "The rule makes clear that offerings made prior to the filing of the registration statement and made under circumstances which did not necessitate registration or contemplate registration, do not by the fact of registration become the type of offerings which are

It is established that one claiming the benefit of an exception to a general statutory scheme must sustain the burden of demonstrating its applicability to his case. *Schlemmer* v. *Buffalo, Rochester and Pittsburg Railway Co.*, 205 U. S. 1, 10; *United States* v. *Cook*, 17 Wall. 168; *Commonwealth* v. *Hart*, 11 Cush. (Mass.) 130, 134.[5] Such a burden was imposed on the one claiming an exemption under Section 4 (1) of the Act in the only case raising this issue before a Circuit Court of Appeals. *Securities and Exchange Commission* v. *Sunbeam Gold Mining Co.*, 95 F. (2d) 699, 702 (C. C. A. 9th). The purposes and scheme of the Act, which militate against all but the narrowest scope for this exemption, furnish ample reason for imposing such a burden on petitioner here. Admittedly, however, petitioner has failed to sustain such a burden. Quite to the contrary, petitioner concedes that "the record does not satisfactorily show that petitioner bought the stock purely as an investment" (Pet. Br. 8).

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prohibited by the Securities Act. The rule allows those who have contemplated or begun to undertake a private offering to register the securities without incurring any risk of liability as a consequence of having first contemplated or begun to undertake a private offering." S. E. C. Release No. 305 (March 2, 1935), *infra*, Appendix C.

[5] See also *Grand Trunk Railway Company* v. *United States*, 229 Fed. 116 (C. C. A. 7th), certiorari denied, 241 U. S. 681; *The Algie*, 56 F. (2d) 388 (E. D. N. Y.); *United States* v. *Randell*, 49 F. (2d) 344 (E. D. N. Y.); *Weare* v. *United States*, 1 F. (2d) 617 (C. C. A. 8th).

Accordingly, petitioner cannot successfully contend that the sales of the stock covered by the option agreement were not in violation of Section 5 (a).

The Supreme Court of Idaho might have rested upon the failure of petitioner to prove that the exemption conferred by Section 4 (1) was applicable to its case. Instead, it went further and found affirmatively against petitioner on the facts.* It follows that, unless this Court overturns these findings of fact, there can be no doubt that the sales of the stock covered by the option agreement violated Section 5 (a) of the Act.

B. THE RIGHTS OF THE PARTIES UNDER THE OPTION AGREEMENT AS AFFECTED BY THE SECURITIES ACT OF 1933

There can be no doubt that each of the parties who participated in the sales of the stock covered by the option agreement was equally guilty of vio-

*The Supreme Court of Idaho stated (R. 229): "*The proof* rather than sustaining the burden of showing that the transaction was exempted *affirmatively shows that all the stock offered for sale amounted to public offerings* and that interstate means of communication and transportation were used in connection therewith." Certainly the facts disclosed by the option agreement itself and the so-called subsequent modifications by letter, etc., and the many letters passing between Frost & Company and Coeur d'Alene Mines Company, *recognizing that Frost & Company was selling the treasury stock to all and sundry*, directing delivery of such treasury stock to other stock firms or brokers for sale to or by them flatly refutes such contention as does likewise the case of *Securities and Exchange Commission* v. *Sunbeam Gold Mining Co.*, 95 F. (2d) 699." [Italics supplied.]

lating Section 5 (a) of the Act. It is immaterial that, as between the parties, respondent may have undertaken to register the stock or that, in view of Section 6, only respondent can be regarded as having access to the information required in the registration statement (cf. Pet. Br. 16, 20). Section 5 (a) makes it unlawful for "any person" to make use of the mails or an instrumentality of interstate commerce to sell a security unless a registration statement is in effect as to such security. The duty thus commanded is required of petitioner as well as of respondent.

The Supreme Court of Idaho, moreover, appears to have regarded the option agreement as an integral feature of the sales of treasury stock in violation of the Section 5 (a). Thus, it observed (R. 229) that the "evidence clearly supports the proposition that the dealings between Frost & Company and Coeur d'Alene Mines Corporation were in contravention" of Section 5 (a) and later stated (R. 232) that "It should be borne in mind that the option agreement * * * prohibited by law." Ample support for the view taken by the court can be found in the extensive sales of the optioned stock in violation of the Act, which were effected prior to the breach (see R. 214). There remains for consideration the effect of the illegality—in which both parties actively engaged—upon their rights under the option agreement.

At the threshold of this inquiry there arises the issue whether the rights of the parties as between themselves should be governed by state or by federal law. See *Awotin* v. *Atlas Exchange Bank,* 295 U. S. 209, 213; *Danciger* v. *Cooley,* 248 U. S. 319, 328; *Sage* v. *Hampe,* 235 U. S. 99. Compare *Board of Commissioners* v. *United States,* 308 U. S. 343; *Deitrick* v. *Greaney,* 309 U. S. 190, 200. It is not entirely clear on this record whether the Idaho Supreme Court in determining the extent and nature of the legal consequences flowing from the unlawful transaction applied concepts derived from local law or from the Securities Act of 1933 and the policy thereby adopted. The decision that the option agreement is void is rested solely upon the fact that it is prohibited by the Securities Act of 1933, presumably because the option was an integral feature of the unlawful sales (R. 231–232). The consequences flowing from this determination appear to be founded on two considerations: recovery on the second cause of action for underwriting profits is barred, at one point, solely because the option agreement is void under the Securities Act (R. 231); at another, recovery on both causes of action is barred in view of the doctrine, whether state or federal is not clear, that parties in "pari delicto" will be left where the courts find them (R. 232–234). But, in any view, since the defense of respondent and the decision on review are both founded ultimately upon the Securities

Act, this Court would appear to have jurisdiction to determine whether the granting of relief on either cause of action would conflict with the Act and the policy which it adopted. *Awotin* v. *Atlas Exchange Bank,* 295 U. S. 209, 213; *Sage* v. *Hampe,* 235 U. S. 99. Compare *Deitrick* v. *Greaney,* 309 U. S. 190, 200; *Board of Commissioners* v. *United States,* 308 U. S. 343, and cases cited.

The precise issues before this Court are whether—in view of the course of conduct in violation of Section 5 (a) actively engaged in by both the issuer and the underwriter—the underwriter may recover from the issuer (a) damages for failure to deliver additional stock under the option agreement and (b) underwriting profits resulting from sales of the delivered stock. The Commission is of the opinion that the recovery or the denial of recovery on either cause of action would constitute no threat to rights given or guaranteed to investors by the Securities Act of 1933. The Commission, accordingly, expresses no opinion as to whether the precise issues in this case should be determined by state or by federal law. See *Board of Commissioners* v. *United States,* 308 U. S. 343, 352. Nor does the Commission take any position on the question whether, assuming the absence of governing federal policy deriving from the Securities Act, the decision of the Supreme Court of Idaho should be affirmed as resting on an adequate state ground or

should be remanded for clarification. Compare *Minnesota* v. *National Tea Co.*, 309 U. S. 551; *Danciger* v. *Cooley*, 248 U. S. 319, 328.

The Commission has, however, a marked interest in a variant of the situation before this Court. In the more usual case, the securities will have been sold by the underwriter, not by the issuer, and the underwriter will be in possession of the proceeds of the sales. Normally, of course, the issuing corporation would have a valid cause of action against the underwriter for the amount of the proceeds less earned underwriting commissions. But it might be the case, as it is here, that both the issuer and the underwriter had participated in the sales and that the sales had violated Section 5 (a) of the Securities Act. It is important that such violations of the Act should not be made the occasion for judicial decisions which would tend to nullify the purposes of the Act.

The fundamental purpose of the Securities Act of 1933, as we stated under Point A, is to protect the investing public. The Act furnishes one form of protection by insisting that "every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information" to the end that "no essentially important element attending the issue shall be concealed from the buying public." Message of the President to the Congress, March 29, 1933. It is obvious that the purposes of the Act would be defeated by any judicial

doctrine which prevented the issuing corporation from recovering from the underwriter, and putting to the intended use in its business, the money invested by the public in the issuer. And it would be anomalous to rest such an injury to the investors upon the fact that the transaction in which the securities were distributed violated the Act, which was designed to protect those investors. Compare Sections 11 and 12 which, by implication, permit a purchaser to affirm a sale in violation of the Act. It can scarcely be assumed that any court would render such an unfortunate decision. Yet this would be the logical consequence of applying literally the broad language used by the Supreme Court of Idaho in stating the proposition that the courts will not lend their aid to the parties to a contract that is prohibited by law or is against public policy (R. 232–234).

It appears to us to be entirely immaterial whether in such a case, the agreement is labelled "void" or the parties are held to be "in pari delicto." There, labels, as often is the case, merely state the conclusion reached, but do not aid in solution of the problem. The ultimate issue is whether the result in the particular case would effectuate or frustrate the purposes of the Act. See, e. g., *Deitrick* v. *Greaney*, 309 U. S. 190; *Chapman* v. *County of Douglas*, 107 U. S. 348; *Doherty* v. *McAuliffe*, 74 F. (2d) 800, 802 (C. C. A. 1st), certiorari denied, 294 U. S. 730; Gellhorn, *Contracts and Public Pol-*

icy (1935), 35 Columbia Law Review 679.[7] It is our contention that, for the reasons stated, the refusal of recovery in the hypothetical, but more usual, case which we have posed would conflict directly with the Securities Act of 1933 and the policy it adopted.

The Commission also suggests that such a result is not simply a rule to be commended to the state courts but is required under the Securities Act of 1933. The state court when it accepts jurisdiction to settle the rights of the parties to a contract must, of necessity, refer to the governing federal enactments and the policies which Congress has thereby adopted. *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209, 213; *Sage* v. *Hampe*, 235 U. S. 99. Surely, it follows that, in determining the consequences which should flow from an illegal course of conduct, the state court must be guided by the policy of the federal act.

Respectfully submitted.

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[7] See also *Williston on Contracts* (Rev. ed.), sec. 1762; *Bowditch* v. *New England Mutual Ins. Co.*, 141 Mass. 292, 4 N. E. 798 (1886); *Kneeland* v. *Emerton*, 280 Mass. 371, 183 N. E. 155 (1932).

APPENDIX A

Provisions of Securities Act of 1933, c. 38, 48 Stat. 74, as amended by the Securities Exchange Act of 1934, c. 404, 48 Stat. 881, 905, Title II.

SEC. 2. [15 U. S. C. § 77b] When used in this title, unless the context otherwise requires—

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of interest in property, tangible or intangible, or, in general, any instrument commonly known as a security, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrant or right to subscribe to or purchase, any of the foregoing.

* * * * *

(3) The term "sale," "sell," "offer to sell," or "offer for sale" shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter. * * *

* * * * *

(4) The term "issuer" means every person who issues or proposes to issue any security; * * *

* * * * *

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

(12) The term "dealer" means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.

* * * * * *

SEC. 4 [15 U. S. C., § 77d]. The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; * * *

* * * * * *

SEC. 5 [15 U. S. C., § 77e]. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication

in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10.

* * * * * *

SEC. 6. [15 U. S. C., § 77f] (a) Any security may be registered with the Commission under the terms and conditions hereinafter provided, by filing a registration statement in triplicate, at least one of which shall be signed by each issuer, its principal executive officer or officers, its principal financial officer, its comptroller or principal accounting officer, and the majority of its board of directors or persons performing similar functions (or, if there is no board of directors or persons performing similar functions, by the majority of the persons or board having the power of management of

the issuer), and in case the issuer is a foreign or Territorial person by its duly authorized representative in the United States;

* * * * *

SEC. 12. [15 U. S. C. § 771] Any person who—

(1) sells a security in violation of section 5, or

(2) sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

* * * * *

SEC. 14. [15 U. S. C., § 77n] Any condition, stipulation, or provision binding any

person acquiring any security to waive compliance with any provision of this title or of the rules and regulations of the Commission shall be void.

* * * * * *

SEC. 16. [15 U. S. C., § 77p] The rights and remedies provided by this title shall be in addition to any and all other rights and remedies that may not exist at law or in equity.

SEC. 17. [15 U. S. C., § 77q] (a) It shall be unlawful for any person in the sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

(b) It shall be unlawful for any person, by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, to publish, give publicity to, or circulate any notice, circular, advertisement, newspaper, article, letter, investment service, or communication which, though not purporting to offer a security for sale describes such security for a consideration received or to

be received, directly or indirectly, from an issuer, underwriter, or dealer, without fully disclosing the receipt, whether past or prospective, of such consideration and the amount thereof.

* * * * * *

SEC. 20 [15 U. S. C., § 77t]. * * *

(b) Whenever it shall appear to the Commission that any person is engaged or about to engage in any acts or practices which constitute or will constitute a violation of the provisions of this title, or of any rule or regulation prescribed under authority thereof, it may, in its discretion, bring an action in any district court of the United States, United States court of any Territory, or the Supreme Court of the District of Columbia to enjoin such acts or practices, and upon a proper showing, a permanent or temporary injunction or restraining order shall be granted without bond. * * *

* * * * * *

SEC. 24 [15 U. S. C., § 77x]. Any person who willfully violates any of the provisions of this title, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both.

APPENDIX B

For Immediate Release, Thursday, January 24, 1935.

Securities and Exchange Commission
WASHINGTON

Securities Act of 1933.
Release No. 285.

The Securities and Exchange Commission, feeling that the present tendency of large issuers to resort to so-called "private financing" may in many instances be at variance with the law, and that such a tendency is undesirable from the standpoint of thousands of prospective investors who are likely to be deprived of opportunities to participate in sound issues through this device, has today made public the following opinion of its General Counsel, John J. Burns. This opinion concerns the exemption created by the second clause of Section 4 (1) of the Securities Act, which exempts "transactions by an issuer not involving any public offering."

Some misunderstanding has arisen as to the meaning of this provision because correspondents have failed to confine previous opinions of the General Counsel to the exact facts on which the opinions were based. The present opinion indicates the many factors which must be considered in determining the availability of this exemption, and points out that a definite opinion in advance is impossible except in a few clear cases.

The principal factors to be considered are: 1. The number of offerees and their relationship to each other and to the issuer; 2. The number of units offered; 3. The size of the offering; and 4. The manner of offering. Issuers are also warned of the practical difficulty which purchasers would have in redistributing securities originally issued without registration in reliance on this exemption.

The full text of the opinion, which was given in the case of a proposed offering of $1,766,000 of Preferred Stock to 25 offerees, follows:

> The opinion has been previously expressed by this office that an offering of securities to an insubstantial number of persons is a transaction by the issuer not involving any public offering, and hence an exempted transaction under the provisions of Section 4 (1) of the Securities Act. Furthermore, the opinion has been expressed that under ordinary circumstances an offering to not more than approximately twenty-five persons is not an offering to a substantial number and presumably does not involve a public offering.
>
> As a result of such opinions there appears to be developing a general practice on the part of issuers desiring to avoid registration of their securities to seek to dispose of the same to insurance companies or other institutions, which, at the time of purchase, state that they are acquiring such securities for investment and not with a view to distribution.
>
> I would call your attention to the fact that in previous opinions it has been expressly recognized that the determination of what constitutes a public offering is essentially a

question of fact, in which all surrounding circumstances are of moment. In no sense is the question to be determined exclusively by the number of prospective offerees. I conceive that the following factors in particular should be considered in determining whether a public offering is involved in a given transaction:

1. The number of offerees and their relationship to each other and to the issuer.

You will note that this does not mean the number of actual purchasers, but the number of persons to whom the security in question is offered for sale. The word "offering" in this sense should not be limited to those cases wherein a formal proposal for a firm commitment is submitted. Any attempt to dispose of a security should be regarded as an offer. I have very serious doubt as to whether in many of those cases where it is stated that an offering is to be made only to an insubstantial number of persons, there may not be preliminary conversations for the purpose of ascertaining which of various possible purchasers would be willing to accept an offer of the security in question if it were made to them. Any such preliminary negotiations or conversations with a substantial number of prospective purchasers would, in my opinion, cause the offering in question to be a public offering, thereby necessitating prior registration of the security in question.

Again, in determining what constitutes a substantial number of offerees the basis on which the offerees are selected is of the greatest importance. Thus, an offering to a given number of persons chosen from the general public on the ground that they are possible purchasers may be a public offering even though an offering to a larger number of per-

sons who are all the members of a particular class, membership in which may be determined by the application of some pre-existing standard, would be a nonpublic offering. However, I have no doubt but that an offering restricted to a particular group or class may nevertheless be a public offering if it is open to a sufficient number of persons.

I also regard as significant the relationship between the issuer and the offerees. Thus, an offering to the members of a class who should have special knowledge of the issuer is less likely to be a public offering than is an offering to the members of a class of the same size who do not have this advantage. This factor would be particularly important in offerings to employees, where a class of high executive officers would have a special relationship to the issuer which subordinate employees would not enjoy.

2. *The number of units offered.*

If the denominations of the units are such that only an insubstantial number of units is offered, presumably no public offering would be involved. But where many units are offered in small denominations, or are convertible into small denominations, there is some indication that the issuer recognizes the possibility, if not the probability, of a distribution of the security to the public generally. The purpose of the exemption of non-public offerings would appear to have been to make registration unnecessary in these relatively few cases where an issuer desires to consummate a transaction or a few transactions and where the transaction or transactions are of such a nature that the securities in question are not likely to come into the hands of the general public.

In connection with a consideration of the number of units offered, I would also consider whether the same or other securities of the same issuer are being offered at the same time. I feel that this circumstance has a bearing on the character of the offering.

3. *The size of the offering.*

It should be noted that the exemption of Section 4 (1) is of transactions by an issuer *not involving* any public offering. In view of this language, it would appear to be proper to consider not merely the specific transaction or transactions between the issuer and the initial purchasers, but also the extent to which a later public offering of all or part of the securities sold by the issuer is likely. Hence I feel that this exemption was intended to be applied chiefly to small offerings, which in their nature are less likely to be publicly offered even if redistributed.

For the same reason I feel that a material consideration is whether the security in question is part of an issue already dealt in by the public, either on a national securities exchange or on the over-the-counter market, or, within the reasonable contemplation of the parties, is likely thus to be dealt in shortly after its issuance. This factor again may indicate whether public distribution of the security in question is likely within a reasonable time.

4. *The manner of offering.*

I have already indicated my opinion that the purpose of the exemption of nonpublic offerings is largely limited to those cases wherein the issuer desires to consummate a few transactions with particular persons.

Consequently, I feel that transactions which are effected by direct negotiation by the issuer are much more likely to be nonpublic than those effected through the use of the machinery of public distribution.

I have gone into this matter at length in order that you may be apprised of the many elements which in my opinion go into the determination of what constitutes a transaction not involving any public offering. There may be some situations where all the factors are so clear that it would be possible to express a definite opinion. In a situation such as you present, however, I feel that the offering would be carefully scrutinized by any court before which it may come and that any letter which purported to describe the situation, and on which my opinion would necessarily be based, could not, adequately advise as to the various factors which are involved.

I call your attention to the fact that any dealer who might subsequently purchase from an initial purchaser the securities which you propose to offer, would be required to satisfy himself that the initial purchaser had not purchased with a view to distribution. If the initial purchaser had purchased with this intent, he would be an underwriter, and sales by a dealer of securities bought by him from such an initial purchaser would, as a general rule, not be exempt until at least a year after the purchase of the securities by the dealer. The sale of unregistered securities to a limited number of initial purchasers, therefore, leads to a practical situation in which such initial purchasers may have difficulty in disposing of the securities purchased by them. Any opinion which I might render in con-

nection with the proposed offering might, I fear, be availed of by the issuer or by an initial purchaser as a means of satisfying a dealer, at a later date, that he might purchase the securities in question and market them without risk of violating the Act. You will appreciate that my opinion would not actually have this effect, since in the case of each transaction there would be involved various matters of fact on which I am not in a position to express an opinion.

Accordingly, it seems a much wiser policy for me not to express an opinion in the situation which you present as to whether a public offering is involved.

For Immediate Release Monday, December 16, 1935.

Securities and Exchange Commission
Washington

Securities Act of 1933.
Release No. 603 (Class C).

The Securities and Exchange Commission today made public an opinion of its General Counsel, John J. Burns, concerning the application of the registration requirements of the Securities Act of 1933 to the distribution to the public by dealers of unregistered securities which are part of a block originally issued in connection with a so-called "private offering." This opinion supplements the discussion of the problem in Release No. 285, which indicated that the necessity of registration before sales of such securities by dealers would depend upon whether the initial purchasers from whom the dealers had

bought the securities in question had acquired them for investment or with a view to distribution.

The General Counsel's recent letter contains a warning that a mere statement by the initial purchaser at the time of his acquisition that such acquisition was for investment is not conclusive as to his actual intent. The opinion suggests that among the relevant factors which should be considered by a dealer in determining whether he may lawfully participate in the sale of such securities are the relations between the issuer and the initial purchaser, the business of the latter, and the length of time elapsing between such acquisition and resale to the dealer.

The excerpt from the General Counsel's letter, which was in answer to an inquiry whether a dealer might resell to the public without registration a block of securities bought from an initial purchaser who had acquired the securities in connection with a "private offering," is as follows:

> I call your attention to my opinion set out in the next to the last paragraph of Release No. 295, which states in substance, that the answer to your question depends upon whether the initial purchaser acquired the securities with a view to distribution, and further points out that if his acquisition was with such intent, he would be an underwriter, so that in general sales by dealers of securities bought from him would not be exempt from registration.
>
> You will appreciate that the intent of the initial purchaser at the time of acquisition is a question of fact upon which you must satisfy yourself, and upon which I can express no opinion.

I wish to make clear, however, that I do not believe the fact that the initial purchaser has stated that his original purchase was for investment and not for resale is necessarily conclusive on this question. In my opinion there should be considered such other factors as: (1) the relation between the issuer and the initial purchaser; (2) the business of the latter, as for example, whether such purchaser is an underwriter or dealer in securities, and, if not, whether the purchase of such a block of securities for investment is consistent with its general operations; and (3) the length of time elapsing between the acquisition of the securities by the initial purchaser and the date of their proposed resale.

Of course, if the securities in question were in fact purchased by the initial purchaser for investment rather than for resale, dealers' sales thereof to the public would not necessitate registration under the Securities Act.

In conclusion, I feel that I should point out that even though a dealer is satisfied that a particular block of unregistered securities was bought by an initial purchaser for investment, he nevertheless takes the risk that, if his determination is incorrect, sales by him of such securities will be in violation of the registration requirements of the Act.

APPENDIX C

For IMMEDIATE RELEASE Saturday, March 2, 1935.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON

SECURITIES ACT OF 1933.
Release No. 305.

The Securities and Exchange Commission today announced the adoption of the following rule defining transactions not involving any public offering made prior to the filing of a registration statement. The rule makes clear that offerings made prior to the filing of the registration statement and made under circumstances which did not necessitate registration or contemplate registration, do not by the fact of registration become the type of offerings which are prohibited by the Securities Act. The rule allows those who have contemplated or begun to undertake a private offering to register the securities without incurring any risk of liability as a consequence of having first contemplated or begun to undertake a private offering. The rule is as follows:

Regulating defining transactions not involving any public offering made prior to filing of registration statement. The phrase "transactions by an issuer not involving any public offering" as used in Section 4 (1) of the Securities Act of 1933 shall be deemed to apply to transactions not involving any public offering at the time of said transactions, although subsequently thereto the issuer decides to make a public offering and/or files a registration statement.

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SUPREME COURT OF THE UNITED STATES.

No. 78.—October Term, 1940.

A. C. Frost & Company, Petitioner, vs. Coeur D'Alene Mines Corporation. } On Writ of Certiorari to the Supreme Court of the State of Idaho.

[January 20, 1941.]

Mr. Justice McReynolds delivered the opinion of the Court.

September 10, 1934, respondent, by a written contract, gave to one Boland "the sole and exclusive right and option to purchase the whole or any part" of 1,300,000 shares of its treasury stock at 10 cents per share, payments to be made in installments. He immediately assigned the contract to petitioner, Frost & Company. April 26, 1935, this was modified as to time and amount of payments. May 15, 1935, another modification authorized respondent to sell optioned stock and credit petitioner with the proceeds above 10 cents per share.

Petitioner obtained 165,000 shares and paid therefor $16,500. Respondent sold many at prices above 10 cents and gave petitioner credits amounting to $16,306. None of the corporation's shares were registered under the Securities Act of 1933 as amended, c. 38, 48 Stat. 74; c. 404, 48 Stat. 881, 905. And upon that alleged ground, in June 1935, respondent refused delivery of the remaining optioned ones—855,150.

By complaint filed in an Idaho state court, March 26, 1937, petitioner charged that respondent had repudiated the option and asked judgment for $16,306, also damages consequent upon breach of the agreement.

The Answer denied liability upon the ground, among others, that the contract "was entered into in violation of law, and particularly in violation of . . . the Security Act of 1933, approved May 27, 1933, and Acts of Congress amendatory thereof and supplemental thereto, and particularly in this that the 1,300,000 shares of stock attempted to be sold by the defendant to the said W. J. Boland under said instrument was the treasury stock of the defendant corporation, and had never been registered for

sale under said National Securities Act, or Acts amendatory thereof or supplemental thereto, with the Securities and Exchange Commission, and that the said W. J. Boland knew these facts and knew that the defendant could not legally sell to him the said stock or any part thereof; and defendant alleges that said contract was void ab initio."

The cause was tried without a jury. Some evidence tended to show that both parties purposed that petitioner would sell acquired shares to sundry parties through use of the mails and instrumentalities of interstate commerce.

The trial court held the option unenforceable so far as not executed because contrary to law; that petitioner could recover the $16,306 credit; also that there could be no recovery for respondent's failure to deliver.

Upon appeal, the supreme court ruled that, as intended, petitioner sold acquired shares to sundry purchasers, directed deliveries to brokers for resale and "that all stock offered for sale amounted to public offerings and that interstate means of communication and transportation were used in connection therewith". Consequently it declared the agreement void ab initio. Further that the parties must be left in the situation where found. It ordered final judgment for respondent. This action was based wholly on interpretation and application of the Securities Act. Thus a federal question arose which demands determination. *Awotin* v. *Atlas Exchange Bank*, 295 U. S. 209, 213.

The essential purpose of the statute is to protect investors by requiring publication of certain information concerning securities before offered for sale.

Some of its relevant provisions are in the margin.[1]

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[1] Securities Act of 1933 as amended, 48 Stat. 74, 78, in 1934, 48 Stat. 881, 905-6.

"Sec. 2. [15 U. S. C. § 77b]. When used in this title, unless the context otherwise requires—

"(3) The term 'sale,' 'sell,' 'offer to sell,' or 'offer for sale' shall include every contract of sale or disposition of, attempt or offer to dispose of, or solicitation of an offer to buy, a security or interest in a security, for value; except that such terms shall not include preliminary negotiations or agreements between an issuer and any underwriter, ..."

"Sec. 4 [15 U. S. C., § 77d]. The provisions of section 5 shall not apply to any of the following transactions:

"(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; . . . ."

"Sec. 5 [15 U. S. C., § 77e]. (a) Unless a registration statement is in

Petitioner maintains that the record shows there was no public offering of optioned stock within the meaning of the statute and Section 4(1) is controlling. Considering the interpretation which we adopt it is unnecessary now to pass upon the point. The Supreme Court of Idaho thought the evidence sufficient to show a public offering and, for present purposes only we may accept that view.

No provision of the Act declares that in the absence of registration, contracts in contemplation of or having relation to a

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effect as to a security, it shall be unlawful for any person, directly or indirectly—

"(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell or offer to buy such security through the use or medium of any prospectus or otherwise; or

"(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

"(b) It shall be unlawful for any person, directly or indirectly—

"(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security registered under this title, unless such prospectus meets the requirements of section 10; or

"(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of section 10."

Section 11 [U. S. C. § 77k] permits security holders to sue specified persons who, in some way, make, permit or use an untrue statement in a registration statement, etc.

"Sec. 12. [15 U. S. C. §771]. Any person who—

"(1) sells a security in violation of section 5, or

"(2) sells a security (whether or not exempted by the provisions of section 3, other than paragraph (2) of subsection (a) thereof), by the use of any means or instruments or transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission, shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security."

"Sec. 24 [15 U. S. C., § 77x]. Any person who willfully violates any of the provisions of this title, or the rules and regulations promulgated by the Commission under authority thereof, or any person who willfully in a registration statement filed under this title, makes any untrue statement of a material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading, shall upon conviction be fined not more than $5,000 or imprisoned not more than five years, or both."

public offering shall be void. If there has been no registration, it penalizes the doing of certain designated things—use of the mails, instrumentalities of interstate commerce, etc. It also declares that those who participate in proscribed action shall become liable to purchasers of the securities "who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security." These are the sanctions which Congress has definitely provided in order to insure obedience to the statute. When invoked they must be given effect.

Although the challenged contract bears no evidence of criminality and is fair upon its face, we are asked to apply a sanction beyond that specified by declaring it null and void because of relationship to a public offering. The basis for this demand is a supposed federal public policy which requires such anr ment in order to secure observance, effectuate the legislative purpose and prevent noxious consequences.

Courts have often added a sanction to those prescribed for an offense created by statute where the circumstances fairly indicated this would further the essential purpose of the enactment; but we think where the contrary definitely appears—actual hindrance indeed of that purpose—no such addition is permissible. The latter situation is beyond the reason which supports the doctrine now relied upon.

Here the clear legislative purpose was protection of innocent purchasers of securities. They are given definite remedies inconsistent with the idea that every contract having relation to sales of unregistered shares is absolutely void; and to accept the conclusion reached by the Supreme Court below would probably seriously hinder rather than aid the real purpose of the statute.

The Securities & Exchange Commission, by permission, has filed a memorandum pointing out how this purpose may be thwarted and the investing public injured if the ruling below is approved. An excerpt from this is copied below.[2]

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[2] EXCERPT FROM MEMORANDUM OF THE SECURITIES AND EXCHANGE COMMISSION: "The fundamental purpose of the Securities Act of 1933, as we stated under Point A, is to protect the investing public. The Act furnishes one form of protection by insisting that 'every issue of new securities to be sold in interstate commerce shall be accompanied by full publicity and information' to the end that 'no essentially important element attending the issue shall be con-

The rule that contracts in contravention of public policy are not enforceable came under discussion in *Steele* v. *Drummond,* 275 U. S. 199 and *Twin City Co.* v. *Harding Glass Co.,* 283 U. S. 353, 356, 357. In the latter the opinion declares, the principle "should be applied with caution and only in cases plainly within the reasons on which that doctrine rests. It is only because of the dominant public interest that one who, like respondent, has had the benefit of performance by the other party will be permitted to avoid his own promise."

The protean basis underlying this doctrine has often been stated thus—No one can lawfully do that which tends to injure the public or is detrimental to the public good. If it definitely appears that enforcement of a contract will not be followed by injurious results, generally, at least, what the parties have agreed to ought not to be struck down.

Kimen v. *Atlas Exchange Bank,* 295 U. S. 215 and *Dietrick* v. *Greaney,* 309 U. S. 190, pointed out that whether a contract shall be enforced required consideration of the broad purposes of relevant statutes and the probable effect upon this. In both causes the end which Congress intended to accomplish was treated as the controlling factor.

The Supreme Court of Idaho, we think, misinterpreted and improperly applied the Securities Act. Its judgment must be reversed.

Reversed.

Mr. Justice STONE concurs in the result.

Mr. Justice DOUGLAS took no part in the consideration or decision of this cause.

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cealed from the buying public.' Message of the President to the Congress, March 29, 1933. It is obvious that the purposes of the Act would be defeated by any judicial doctrine which prevented the issuing corporation from recovering from the underwriter, and putting to the intended use in its business, the money invested by the public in the issuer. And it would be anomalous to rest such an injury to the investors upon the fact that the transaction in which the securities were distributed violated the Act, which was designed to protect those investors. Compare Sections 11 and 12 which, by implication, permit a purchaser to affirm a sale in violation of the Act. It can scarcely be assumed that any court would render such an unfortunate decision. Yet this would be the logical consequence of applying literally the broad language used by the Supreme Court of Idaho in stating the proposition that the courts will not lend their aid to the parties to a contract that is prohibited by law or is against public policy.

"It appears to us to be entirely immaterial whether in such a case, the agreement is labelled 'void' or the parties are held to be 'in pari delicto.' There, labels, as often is the case, merely state the conclusion reached, but do not aid in solution of the problem. The ultimate issue is whether the result in the particular case would effectuate or frustrate the purposes of the Act."